

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF BUTLER COUNTY WATER)
SYSTEM, INC., BUTLER COUNTY, KENTUCKY,)
(1) FOR A CERTIFICATE OF PUBLIC CON-)
VENIENCE AND NECESSITY AUTHORIZING SAID)
SYSTEM TO CONSTRUCT MAJOR IMPROVEMENTS)
AND ADDITIONS TO ITS EXISTING MUNICIPAL)
WATER DISTRIBUTION SYSTEM PURSUANT TO)
THE PROVISIONS OF KRS 278.020 OF THE)
KENTUCKY REVISED STATUTES; AND (2))
SEEKING APPROVAL OF THE ISSUANCE OF)
CERTAIN SECURITIES AS REQUIRED BY KRS)
278.030; AND (3) APPROVAL OF ONE WATER)
RATE STRUCTURE FOR ALL CUSTOMERS)

CASE NO. 9505

O R D E R

Butler County Water System, Inc. ("Butler"), by application filed January 30, 1986, as revised in its amended application of September 12, 1986, is seeking approval of an adjustment to its water service rates, authorization to construct an \$834,000 water-works project, and approval of its financing for the proposed project. The project is to be financed by a loan of \$369,000 from the Farmers Home Administration ("FmHA") at 5 percent annual interest, a \$31,000 grant from the FmHA, a \$409,000 Community Development Block Grant ("CDBG") and \$25,000 from applicants for service. Butler has entered into a security agreement with the FmHA for the loan. The repayment period for the loan will be 40 years.

The proposed construction will provide water service to about 245 new customers. Plans and specifications prepared by Warren

Rural Electric Cooperative Corporation, Bowling Green, Kentucky, ("Engineer") have been approved by the Division of Water of the Natural Resources and Environmental Protection Cabinet.

A hearing was held in the offices of the Public Service Commission, Frankfort, Kentucky, on October 7, 1986. There were no intervenors and no protests were entered.

The requested rates found reasonable herein will produce additional annual gross revenues of \$41,514 from water sales, and \$1,849 from other operating revenues.

TEST PERIOD

Butler proposed and the Commission has accepted the 12-month period ending July 31, 1986, as the test period in this matter.

REVENUES AND EXPENSES

Butler reported a net loss of \$13,959 for the test period and proposed numerous pro forma adjustments to its test-period operating revenues and expenses to reflect prospective operating conditions. The Commission finds these adjustments generally to be within reason; however, this decision does not imply the Commission's future acceptance of these or similar adjustments not meeting the Commission's criteria of being known and measurable. Therefore, they have been accepted for rate-making purposes with the following exception:

Depreciation Expense

At the end of the test period, Butler had recorded depreciation expense of \$44,807 to which it made a pro forma adjustment of \$16,680 for new construction of \$834,000, for total pro forma depreciation expense of \$61,487. The Commission computes

depreciation expense for rate-making purposes on original cost of the plant in service less contributions in aid of construction, on the ground that recovery should not be allowed on that portion of the plant which has been provided free of cost to the utility.

The Commission has used a rate of 2 percent for allowable depreciation expense, the same as Butler. Thus, after excluding depreciation on contributed property, the Commission finds that the appropriate adjusted test-year depreciation expense is \$29,531.¹

Therefore, Butler's adjusted operations for rate-making purposes at the end of the test period are as follows:

	<u>Butler Adjusted</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$268,477	\$ -0-	\$ 268,477
Operating Expenses	251,870	(31,956)	219,914
Net Operating Income	<u>\$ 16,607</u>	<u>\$ 31,956</u>	<u>\$ 48,563</u>
Other Income	2,759	-0-	2,759
Interest Expense	<u>60,888</u>	<u>-0-</u>	<u>60,888</u>
NET INCOME	<u><u>\$(41,522)</u></u>	<u><u>\$ 31,956</u></u>	<u><u>\$ (9,566)</u></u>

¹ Computation of allowable depreciation expense:

Depreciation expense, per books, July 31, 1986		\$44,807
Add: Pro forma depreciation expense on new construction - \$834,000 @ 2% (Composite rate of Butler per Table 4 - Note 9) -		16,680
Less: Depreciation expense on contributed property: Contributions, existing plant, 7/31/86	\$1,132,812	
Contributions, new construction	465,000	
Total	<u>\$1,597,812</u>	
Composite depreciation rate	X 2%	<u>(31,956)</u>
Allowable depreciation expense		<u><u>\$29,531</u></u>

REVENUE REQUIREMENTS

The Commission has used the debt service coverage ("DSC") method to determine appropriate revenue requirements based on Butler's average debt service for the next 5 years of approximately \$77,093. The adjusted operating income of \$48,563 plus other income of \$2,759 provides a DSC of approximately .67X which is unfair, unjust and unreasonable. The Commission finds a DSC of 1.2X is necessary for Butler to pay its operating expenses and to meet obligations to its lenders. Accordingly, the Commission has determined that the proposed additional revenue of \$41,514 is necessary to provide Butler a DSC of approximately 1.2X.

RATE DESIGN

Butler presently has a separate rate schedule for customers in the Logansport-Dunbar area, which now has been merged with Butler. The single rate schedule proposed by Butler for all customers is in the best interest of its customers and should be approved.

Butler proposed to change the usage increments in its present rate design to more adequately reflect its customers' usage patterns. It followed the methodology contained in the American Water Works Association, Manual M-1, which recommends that rate block limits be established at the points where 80-90 percent of usage for a particular customer class or group has occurred.

Butler found that approximately 85 percent of all usage in the group of 5/8 x 3/4 inch connections occurs below 6,000 gallons per month; therefore, the upper limit of the first rate block is set at that point. The upper limit of the second rate block is

set at 50,000 gallons per month because at this point approximately 85 percent of all usage in the group of larger meters has occurred. The third rate block consists of all usage above 50,000 gallons.

After reviewing the water rate study the Commission finds that Butler's proposed change in rate design is fair, just and reasonable and should be approved.

SUMMARY

The Commission, after consideration of the application and evidence of record and being advised, is of the opinion and finds that:

1. Public convenience and necessity require that the construction proposed in the application and record be performed and that a certificate of public convenience and necessity be granted.

2. The proposed project for the Butler system includes 245 service connections, about 26 miles of 6- and 4-inch water main, and miscellaneous appurtenances. The low bids received for the proposed construction totaled \$634,539, which will require about \$834,000 in project funding after allowances are made for fees, contingencies, other indirect costs and additional construction being considered as a result of receiving bids under the final estimate.

3. Butler should obtain approval from the Commission prior to performing any additional construction not expressly certificated by this Order.

4. Any deviations from the construction herein approved which could adversely affect service to any customer should be done only with the prior approval of this Commission.

5. Butler should furnish duly verified documentation of the total costs of this project including the cost of construction and all other capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed. Said construction costs should be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for Water Utilities prescribed by this Commission.

6. Butler's contract with its Engineer should require full-time resident inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering to insure that the construction work is done in accordance with the contract plans and specifications and in conformance with the best practices of the construction trades involved in the project.

7. Butler should require the Engineer to furnish a copy of the "as-built" drawings and a signed statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the date of substantial completion of this construction.

8. A 5/8-inch x 3/4-inch meter should be the standard customer service meter for all new customers and should be installed at all points of service unless the customer provides sufficient justification for the installation of a larger meter.

9. The financing plan proposed by Butler is for lawful objects within the corporate purposes of its utility operations, is necessary and appropriate for and consistent with the proper performance of services to the public and will not impair its ability to perform these services and should, therefore, be approved.

10. The financing secured by Butler for this project will be needed to pay for the work herein approved. Butler's financing plan should, therefore, be approved.

11. Butler's proposed changes in its rate design are fair, just, and reasonable and should be approved.

12. The rates in Appendix A are the fair, just and reasonable rates to be charged by Butler in that they should produce revenues from water sales of \$301,925 and total gross revenues of \$312,750.

IT IS THEREFORE ORDERED that:

1. Butler be and it hereby is granted a certificate of public convenience and necessity to proceed with the proposed construction project as set forth in the drawings and specifications of record herein.

2. Butler's plan of financing consisting of a loan from the FmHA in the amount of \$369,000 with an interest rate of 5 percent and a 40-year term, a \$31,000 grant from the FmHA, \$409,000 in CDBG funds and \$25,000 from applicants for service be and it hereby is approved.

3. Butler shall comply with all matters set out in Findings 3 through 8 as if the same were individually so ordered.

4. The rates in Appendix A be and they hereby are approved for service rendered by Butler on and after the date of this Order.

5. If under new FmHA loan conditions Butler is notified and granted the option of accepting a lower interest rate at the date of closing, Butler shall file with the Commission the FmHA notification of the lower interest rate and shall provide all correspondence from and to the FmHA concerning this notification within 30 days of the closing date.

6. Butler shall file a statement of the interest rate accepted from FmHA within 30 days of the date of closing.

7. If Butler accepts an interest rate different from the rate approved herein, it shall file amended pages to its bond resolution and an amended amortization schedule.

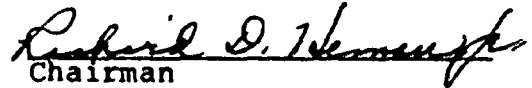
8. If Butler is eligible but does not take advantage of a lower interest rate at the time of closing, it shall fully document why the lower rate was not accepted showing an analysis of the higher costs associated with the loan over its life.

9. Within 30 days from the date of this Order, Butler shall file its revised tariff sheets setting out the rates approved herein.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 11th day of November, 1986.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 9505 DATED 11/11/86

The following rates and charges are prescribed for the customers in the area served by the Butler County Water System, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

RATES: Monthly

5/8 X 3/4-Inch Connection

First 2,000 Gallons	\$ 9.37 Minimum Bill
Next 4,000 Gallons	3.00 Per 1,000 Gallons
Next 44,000 Gallons	2.60 Per 1,000 Gallons
Over 50,000 Gallons	2.20 Per 1,000 Gallons

1-Inch Connection

First 5,000 Gallons	\$ 19.90 Minimum Bill
Next 1,000 Gallons	3.00 Per 1,000 Gallons
Next 44,000 Gallons	2.60 Per 1,000 Gallons
Over 50,000 Gallons	2.20 Per 1,000 Gallons

2-Inch Connection

First 16,000 Gallons	\$53.86 Minimum Bill
Next 34,000 Gallons	2.60 Per 1,000 Gallons
Over 50,000 Gallons	2.20 Per 1,000 Gallons

3-Inch Connection

First 30,000 Gallons	\$94.47 Minimum Bill
Next 20,000 Gallons	2.60 Per 1,000 Gallons
Over 50,000 Gallons	2.20 Per 1,000 Gallons

4-Inch Connection

First 50,000 Gallons	\$152.58 Minimum Bill
Over 50,000 Gallons	2.20 Per 1,000 Gallons

6-Inch Connection

First 100,000 Gallons
Over 100,000 Gallons

\$280.15 Minimum Bill
2.20 Per 1,000 Gallons